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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

JOHN CURRIER,

Petitioner,

v.

ROSALIND FOGEL and GERALD FOGEL,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Petitioner Currier, a garment industry executive, was a director of American Investors Fund, Inc. (the "Fund"), a mutual fund of which respondents are shareholders. In 1975, the Court of Appeals for the Second Circuit held the Fund's investment adviser (the "Adviser"), three management directors and Currier liable for failing adequately to inform outside directors concerning opportunities to recapture brokerage commissions.*

The court noted that Currier, the only unaffiliated, non-management director who had been served with the complaint, was a "special case" due to his outsider status. The court nevertheless held him liable, despite his demonstrated lack of knowledge concerning the complex subject of brokerage commission recapture, because he owned between one and two percent of the Adviser's shares during the period at issue.

The question presented by the Second Circuit's decision as to this petitioner is:

> (1) Whether an unaffiliated director of a mutual fund, with no background in the investment business and no knowledge concerning recapture of brokerage commissions, may be held liable under the Investment Company Act for breach of fiduciary duty to the fund's shareholders for failing to inform his fellow unaffiliated directors of recapture opportunities, solely on the basis of his small ownership interest in the investment adviser to the fund?

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* The parties to the proceedings in the court below, in addition to the parties named in the caption, are George A. Chestnutt, Jr., Warren K. Greene, Stanley L. Sabel, American Investors Corporation and Chestnutt Corporation, who were named as defendants.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner John Currier ("Currier") respectfully petitions for a writ of certiorari to issue to review so much of the judgment of the United States Court of Appeals for the Second Circuit, entered on December 17, 1981, as held (1) that there is an implied private cause of action under the Investment Company Act against directors of a mutual fund for failure to inform the fund's non-management directors of the possibility of recapturing brokerage commissions and (2) that petitioner Currier, a non-management director of the fund, was liable under the Investment Company Act for breach of fiduciary duty for failing to inform the other non-management directors about the possibility of recapture. With respect to the first holding, Currier joins in the arguments presented on behalf of petitioners George A.

Chestnutt, Jr., Warren K. Greene, Stanley L. Sabel, American Investors Corporation and Chestnutt Corporation, who were Currier's co-defendants below, in their separate petition for a writ of certiorari. This petition is addressed solely to the error committed by the court below with respect to the second holding.

OPINIONS BELOW[1]

The court of appeals has written two opinions in this litigation. The more recent opinion is reported at 668 F.2d 100 (2d Cir. 1981) (*"Fogel II"*) (A-2).[2] The opinion of the district court from which the appeal in *Fogel II* was taken is reported at 493 F. Supp. 1192 (S.D.N.Y. 1980) (A-39). The first opinion of the court of appeals is reported at 533 F.2d 731 (2d Cir. 1975) (*"Fogel I"*) (A-77), *cert. denied*, 429 U.S. 824 (1976). *Fogel I* reversed the district court's dismissal of the case after trial on the merits in a decision reported at 383 F. Supp. 914 (S.D.N.Y. 1974) (A-122).

JURISDICTION

The judgment of the court of appeals was entered on December 17, 1981. A timely petition for rehearing and suggestion for rehearing en banc was denied on February 22, 1982. This Court has jurisdiction to review the judgment of the court of appeals by writ of certiorari pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Investment Company Act, 15 U.S.C. § 80a-2(a)(3) and § 80a-2(a)(19) (1981), are set forth in a statutory appendix at the end of this petition.

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1. The opinions below are reprinted in the appendix being filed by Currier's co-defendants in support of their petition for certiorari. References in the form "A- " refer to the appendix to the petition of George A. Chestnutt, Jr. et al., for a writ of certiorari.

2. Petitions for rehearing were denied by order of the court on February 22, 1982. (A-1.)

STATEMENT OF THE CASE

Prior Proceedings[3]

In *Fogel I*, the Court of Appeals for the Second Circuit, relying on the First Circuit's decision in *Moses v. Burgin*, 445 F.2d 369 (1st Cir.), *cert. denied*, 404 U.S. 994 (1971), found that the Adviser and management directors had breached their fiduciary duties to the Fund shareholders by failing adequately to inform the Fund's "independent" directors about possibilities for recapture.[4] (A-108.) As to Currier, the court reasoned:

> "defendant Currier is a special case; although he could be counted as unaffiliated until December 14, 1970, because of his small stock ownership in the Adviser he was in fact not disinterested. We therefore include him with the defendants held to be liable."

(A-108 to -109.)[5]

The court of appeals directed the district court on remand to apportion damages among defendants, petitioners here, and to impose primary responsibility on the Adviser, "which profited from the failure to recapture." (A-109.) On remand, the district court referred the case to a magistrate for a damage hearing. In 1978 the magistrate assessed approximately $350,000 in damages jointly and severally against all petitioners, finding no evidentiary

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3. The proceedings involving all defendants below are summarized by petitioners, George A. Chestnutt, Jr. et al., in their separate petition for certiorari. This petition describes only the prior proceedings particularly relevant to Currier's independent arguments.

4. The court of appeals defined the term "independent" so as to exclude Currier from the definition. The term included any director of the Fund who was both not "interested" (15 U.S.C. § 80a-2(a)(19)) after December 14, 1970 *and* not "affiliated" (15 U.S.C. § 80a-2(a)(3)) prior to December 14, 1970. (A-97 n.38.) Due to his ownership of Adviser stock, Currier was statutorily "interested" after December 14, 1970.

5. It should be noted that Currier was in fact "unaffiliated" at all times both before and after December 14, 1970, because he owned less than 5% of the Adviser stock. The "interested" category introduced at the end of 1970 did not supplant the pre-existing "affiliated" category for all purposes.

basis on which to apportion damages, since none had been presented to distinguish Currier from the other defendants, all of whom were represented by common counsel. (A-65.) On June 19, 1980, the district court modified the magistrate's findings on damages, but approved his finding on the issue of apportionment. Final judgment in the amount of $3,919,220 was entered on June 27, 1980. (A-37 to -38.)

Upon Currier's separate appeal from this decision, the Second Circuit agreed that the district court had erred in failing to apportion liability according to relative degree of fault and reduced Currier's liability to an amount relative to the size of his interest in the Adviser. (A-35 to -36.) The court adhered, however, to its holding in *Fogel I* that Currier was liable, "[w]ithout passing on the soundness of Currier's arguments," stating that Currier should have raised these arguments at an earlier stage. (A-34.)

Currier's "Special Case"

In contrast to the affiliated directors, who were Adviser employees actively involved in and controlling the operation of the Fund and Adviser, Currier was a non-management director, with no special knowledge or expertise concerning recapture. (C.A. App. 1135-36; *see* C.A. App. 136-40, 164, 180, 185, 187, 195-97, 240.)[6] Currier never served as an officer or an employee of the Fund and was never involved in the Fund's day-to-day management. (C.A. App. 1135.)

Currier's sole connection with the Adviser was his ownership of Adviser securities. In 1964, Currier acquired 2% of the Adviser's capital stock, at a cost of $11,300, and $4,000 worth of the Adviser's six percent bonds. (C.A. App. 1134-35.) In 1968 and 1969, Currier reduced his stock interest to 1.2%. (C.A. App. 1135.) During the damage period (1967-1973), he received total dividend payments from the Adviser of $1,800, as well as interest on his bonds of at most $1,680, a cumulative total of

6. References in the form "C.A. App. " are to the joint appendix filed by the parties in *Fogel II*.

$3,480. (*Id.*) Currier was also a shareholder of the Fund. During the relevant period, he owned approximately 1000 of its shares, valued at between $4,400 and $8,000. (C.A. App. 1134.)[7]

Currier had no more knowledge about possible methods of recapturing brokerage commissions, or their availability or desirability to the Fund, than did any of the other unaffiliated Fund directors. (C.A. App. 1135-36.) What Currier knew he learned, as did the other non-management directors, from the management directors and counsel for the Fund. (C.A. App. 187-88, 1135-36.) As a result of what he learned Currier believed that the Fund had no potential for recovery of brokerage fees. (C.A. App. 164.)

The court of appeals concluded, after reviewing the testimony of Currier and the other non-management directors, that "it is not clear at all that any of these witnesses thoroughly understood the forms of recapture which the plaintiffs propose." (A-106.)

REASONS FOR GRANTING THE WRIT

This petition should be granted because the court below established an erroneous precedent that is (1) in conflict with the holding of the First Circuit in *Moses v. Burgin* and (2) inequitable and inconsistent with the rationale of both circuits' decisions as applied to petitioner Currier. The holding below is tantamount to creation of a *per se*, strict liability standard for breach of fiduciary duty under the Investment Company Act. This *per se* standard is inconsistent with *Moses v. Burgin*, in which the First Circuit held that intentional conduct is a prerequisite for liability for failure to inform unaffiliated fund directors about recapture. 445 F.2d at 384. No intentional or wrongful conduct on Currier's part was identified either by the court or by plaintiffs, who actually held him out to be the prototype of the uninformed outside director. Currier was unjustly condemned for an omission to communicate information that the court found he did not know.

7. Currier's only compensation from the Fund was receipt of fees for attending board meetings. (C.A. App. 1135.)

1. *The absence of proof of motive or knowledge required by Moses v. Burgin is fatal to the case against Currier.* In finding the "Management defendants" in *Moses* guilty of gross misconduct, the First Circuit stressed the intentional quality of their conduct:

> "Enough has been said to show that Management defendants were not guilty of mere negligence. They *knew* . . . that the possibility of recapture was a serious and unresolved issue in the industry. They also *knew* that it was an issue that involved a potential conflict between their interests and the interests of Fund's shareholders. Their failure to disclose the information available to them to the unaffiliated directors was the result of *neither inadvertence nor misapprehension of the facts.* . . . By *intentionally* pursuing a course of non-disclosure these defendants made the effective functioning of the mechanism protecting Fund from their overreaching impossible. . . . We therefore conclude that the Management defendants were guilty of gross misconduct. . . ."

445 F.2d at 384 (emphasis added).

The evidence shows that Currier, by contrast, believed in good faith that the Adviser could best serve the Fund by not diverting its energies into an unfamiliar area. (C.A. App. 235.) There was no showing that Currier believed that by refraining from recapture the Adviser could profit at the expense of the Fund or that, because of his small equity interest in the Adviser, Currier might indirectly realize some gain from a decision not to recapture. Currier thus stood in the position of the unaffiliated directors in *Moses v. Burgin*, whom the First Circuit exonerated from liability, on grounds they (a) lacked knowledge concerning, or motive to disfavor, recapture and (b) properly relied upon the expertise of the management defendants. 445 F.2d at 384.

2. *Application of a per se standard is inequitable and inconsistent with the rationale of the court below.* Although the court presumed that because Currier owned stock in the Adviser, he must be deemed to have favored the interests of the Adviser

rather than those of the Fund's shareholders, the bare fact of Currier's ownership of a minimal amount of Adviser shares was demonstrably inadequate to support such a presumption as applied to the issue of brokerage recapture. Moreover, because Currier also held an approximately equal ownership interest in the Fund, whatever presumption might have followed from Currier's interest in the Adviser should have been offset by a presumption in favor of the Fund. Because no evidence was introduced that Currier was knowledgeable about the complex issue of recapture, a *per se* standard is both inappropriate and inconsistent with the rationale behind both the First and Second Circuits' imposition of liability upon knowledgeable management directors.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

May 24, 1982

Respectfully submitted,

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STATUTORY APPENDIX

Title 15 of United States Code

§ 80a-2. Definitions

(a) When used in this subchapter, unless the context otherwise requires—

* * *

(3) "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

* * *

(19) "Interested person" of another person means—

(A) when used with respect to an investment company—

(i) any affiliated person of such company,

(ii) any member of the immediate family of any natural person who is an affiliated person of such company,

(iii) any interested person of any investment adviser of or principal underwriter for such company,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two fiscal years of such company has acted as legal counsel for such company,

(v) any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer, and

(vi) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had, at any time since the beginning of the last two fiscal years of such company, a material business or professional relationship with such company or with the principal executive officer of such company or with any other investment company having the same investment adviser or principal underwriter or with the principal executive officer of such other investment company:

Provided, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the immediate family of any person specified in clause (aa) of this proviso; and

(B) when used with respect to an investment adviser of or principal underwriter for any investment company—

(i) any affiliated person of such investment adviser or principal underwriter,

(ii) any member of the immediate family of any natural person who is an affiliated person of such investment adviser or principal underwriter,

(iii) any person who knowingly has any direct or indirect beneficial interest in, or who is designated as trustee, executor, or guardian of any legal interest in, any security issued either by such investment adviser or principal underwriter or by a controlling person of such investment adviser or principal underwriter,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two fiscal years of such investment company has acted as legal counsel for such investment adviser or principal underwriter,

(v) any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer, and

(vi) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had at any time since the beginning of the last two fiscal years of such investment company a material business or professional relationship with such investment adviser or principal underwriter or with the principal executive officer or any controlling person of such investment adviser or principal underwriter.

For the purposes of this paragraph (19), "member of the immediate family" means any parent, spouse of a parent, child, spouse of a child, spouse, brother, or sister, and includes step and adoptive relationships. The Commission may modify or revoke any order issued under clause (vi) of subparagraph (A) or (B) of this paragraph whenever it finds that such order is no longer consistent with the facts. No order issued pursuant to clause (vi) of subparagraph (A) or (B) of this paragraph shall become effective until at least sixty days after the entry thereof, and no such order shall affect the status of any person for the purposes of this subchapter or for any other purpose for any period prior to the effective date of such order.

Nos. 81-2154; 81-2163

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OCTOBER TERM, 1981

No. 81-2154

JOHN CURRIER,

Petitioner,

—v.—

ROSALIND FOGEL and GERALD FOGEL,

Respondents.

No. 81-2163

GEORGE A. CHESTNUTT, JR., WARREN K. GREENE, STANLEY L. SABEL, AMERICAN INVESTORS CORPORATION and CHESTNUTT CORPORATION,

Petitioners,

—v.—

ROSALIND FOGEL and GERALD FOGEL,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO THE PETITIONS FOR WRIT OF CERTIORARI

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

Petitioners, fiduciaries to a mutual fund, were held liable under the Investment Company Act of 1940 for failing to disclose to the independent directors of the fund that a substantial portion of the brokerage commissions paid by the fund could be "recaptured" for the fund's benefit. Petitioners instead used such excess commissions to enrich themselves.

The only questions properly before this Court are:

1. Did the court of appeals properly conclude that petitioners had waived the defense that the complaint failed to state a claim upon which relief can be granted by not including such defense in the pre-trial order and by not raising it at the first trial, on the first appeal, on their two motions for rehearing, in their first petition for a writ of certiorari, or for more than twelve years after the action was commenced?

2. Did the court of appeals properly conclude that whether there is a private right of action under an Act of Congress is not a question of subject matter jurisdiction, but rather a question whether the complaint states a claim upon which relief can be granted?

3. Did the court of appeals properly conclude that its earlier decision, finding petitioners liable, constituted the law of the case and would not be re-examined absent "a clear conviction" that the earlier decision was erroneous?

In addition, the following question is raised by petitioner Currier in No. 81-2154:

1. Did the court of appeals properly conclude, as a matter of fact, that Currier "does not fit the picture of the guileless innocent that counsel seek to draw" and was "in fact not disinterested," even though he was technically an "unaffiliated" director?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

Nos. 81-2154; 81-2163

No. 81-2154

JOHN CURRIER,

Petitioner,

—v.—

ROSALIND FOGEL and GERALD FOGEL,

Respondents.

No. 81-2163

GEORGE A. CHESTNUTT, JR., WARREN K. GREENE, STANLEY L. SABEL, AMERICAN INVESTORS CORPORATION and CHESTNUTT CORPORATION,

Petitioners,

—v.—

ROSALIND FOGEL and GERALD FOGEL,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO THE PETITIONS FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE[1]

The Parties

This shareholders' derivative action was commenced on July 11, 1968, by respondents, Rosalind Fogel and Gerald Fogel, on behalf of American Investors Fund, Inc. ("Fund"), a registered investment company more commonly referred to as a mutual fund. (A. 82)[2] Joined as defendants were petitioner, American Investors Corporation (formerly Chestnutt Corporation), the Fund's investment advisor ("Advisor") and those individuals who were in a position of divided loyalty between the Advisor and the Fund.[3]

The Claim

The complaint charged, *inter alia*, that petitioners had breached their fiduciary duty under the Investment Company Act of 1940 ("ICA") by failing to disclose to the independent directors of the Fund that the Fund could "recapture" the substantial "excess" portion of what were then fixed brokerage commissions paid by the Fund on its securities transactions.[4] Petitioners, fiduciaries of the Fund in an obvious conflict of interest, told the independent directors of the Fund that recap-

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1 A description of the parties to the proceedings, the opinions below, jurisdiction, statutes involved and basis for federal jurisdiction appears in the Petition of George A. Chestnutt, Jr., *et al.*, No. 81-2163 ("Chestnutt Pet.").

2 References prefixed by "A" refer to the Appendix of petitioners Chestnutt, *et al.*, No. 81-2163.

3 Petitioner, George A. Chestnutt, Jr., was president, director and major stockholder of the Advisor and president and director of the Fund; Stanley L. Sabel was vice president, secretary, general counsel, director and 16% stockholder of the Advisor and vice president, secretary, director and general counsel for the Fund; Warren K. Greene was vice president, director and stockholder of the Advisor and vice president and director of the Fund; and John Currier was a stockholder of the Advisor and a director of the Fund. (A 136).

4 The action was brought under the ICA as it existed prior to the 1970 amendments (discussed *infra*). The period covered by the complaint was March 1, 1967 to March 29, 1973. (A. 118).

ture would have been illegal and that the Securities and Exchange Commission's ("SEC") repeated endorsements of recapture did not apply to "no-load" investment companies such as the Fund. Instead, petitioners used these excess brokerage commissions to enrich themselves by rewarding dealers who sold Fund shares (thereby increasing the Advisor's management fee) and by compensating persons who provided the Advisor with investment research (which otherwise the Advisor would have had to pay for out of its management fee). (A. 140-141; 21; 83).[5]

Recapture

Recapture of these excess commissions for the benefit of the Fund would have been a simple task. Like most mutual funds, the Fund bought and sold large amounts of securities for its investment portfolio and paid enormous sums in commissions to the brokers who effected such transactions. (A. 83). At the time, brokerage commission rates per share were fixed by law regardless of the size of the transaction. Since the cost to the broker of executing large orders was not proportionally greater than the cost of small orders, the huge trading volumes generated by mutual funds made investment advisors, who controlled the funds' trading, particularly attractive brokerage customers. (A. 78-79).

In order to obtain advisors' business, brokers were willing to either forego part of their commission in favor of another broker designated by the advisor (who had provided some service to the advisor) or to provide additional services themselves to the advisor at no extra cost (such as selling fund shares or providing investment research). (A. 79). Advisors

5 The relationship between the Advisor and the Fund is typical of the peculiar structure of the mutual fund industry. As this Court noted in *Burks v. Lasker*, 441 U.S. 471, 480-81 (1979), a mutual fund is little more than a corporate shell organized, staffed and controlled by its investment advisor. The advisor manages the day to day operations of the fund, and in particular selects its investments. In return, the advisor receives a management fee calculated as a percentage of the assets of the fund. Thus, it is obviously in the advisor's interest to increase the assets of the fund by stimulating sales of its shares to new shareholders and to receive investment research without having to pay the cost thereof.

naturally found this arrangement to their liking because it increased their profits. (A. 21; 79). The funds, on the other hand, (the *cestuis que trust* of the advisors) were paying the fixed rates, but received little or no benefit. (A. 80).

The SEC criticized the inequity of this arrangement as early as 1963. (A. 80). As a result, a number of advisors devised means to "recapture" the commissions which brokers were willing to forego and credit them against the management fee paid by the funds. (A. 80-81; A. 138). The SEC repeatedly endorsed such recapture. (A. 81-82, 86-90).

Recapture was possible in a number of different ways. The common denominator of the various methods was membership, by a subsidiary of the advisor, in the National Association of Securities Dealers ("NASD") and as an "institutional member" on one of the regional stock exchanges (*e.g.*, the Philadelphia-Baltimore-Washington Stock Exchange, ("PBW")). Both memberships were easily obtainable (A. 109-113) at modest cost (which was offset against the damages awarded below; A. 60, 74-75). Once these memberships had been secured, the advisor could then place fund orders with its regular broker for execution in normal fashion, but direct that the broker pay to the advisor's subsidiary that portion (25-80%; A. 109n.20, 112) of the fixed commissions which the broker was willing to forego.[6] The advisor's subsidiary did not actually have to execute any orders itself (A. 52)—it simply received the payments. These payments could then be credited by the advisor against the management fee paid by the fund. In this way, the "fat" in the fixed commissions accrued to the benefit of the fund (which had paid them) rather than to the advisor (which was already handsomely compensated by the management fee). (*Cf.* A. 56).

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6 The three principal means of payment were called "give-ups"—the broker simply paid a portion (up to 40%; A. 42) of his commission to any NASD member the advisor designated (A. 79); "reciprocal brokerage"—a member of the PBW received commissions on that exchange in proportion (30% or more; A. 57-58) to unrelated business it had sent to members of the New York or American Stock Exchanges (A. 112; 51-60); and "introducing brokerage"—a member of the PBW received up to 80% (A. 42) of the commission paid to the broker who actually executed the transaction on that exchange (A. 44-45; 112). Other means also existed. (A. 45-51).

Proceedings Below

In 1974, following a bench trial limited to the issue of liability, the district court dismissed the complaint on the ground that recapture would not have been legal. (A. 121).

The court of appeals, in *Fogel I,* reversed. (A. 77). After reviewing the trial record, the court held that recapture, as argued by respondents, would have been both possible (A. 109-113) and legal (A. 113-118); that petitioners had failed to disclose to the independent directors that recapture was available (A. 101-108); and that this failure to disclose such a valuable opportunity was a breach of petitioners' fiduciary duty under the ICA, especially since they were using this opportunity for their own benefit. (A. 99-100; 106-108). The court of appeals remanded for a determination of damages in accordance with specific guidance set forth in its opinion. (A. 118-120).

Petitioners sought a rehearing, which was denied; moved to recall the mandate and vacate the judgment, which was denied; and petitioned to this Court for a writ of certiorari, which was denied. *Chestnutt v. Fogel,* 429 U.S. 824 (1976).

On remand, the district court referred the case to a magistrate, who held a trial on the issue of damages. On October 31, 1978, the magistrate awarded damages of $349,013.04 and interest. (A. 63). Both sides objected to the magistrate's report.

After a review of the full record, the district court, on June 19, 1980, modified the magistrate's report. (A. 39). In general, the district court approved the magistrate's findings. (A. 61). In one instance, the magistrate's recommended award was reduced. (*Id.*). In another instance, where the magistrate had awarded no damages at all because of his failure to follow the court of appeals' guidance, the district court found in favor of plaintiffs, but awarded less than the amount claimed. The court, adopting what it called a "more conservative figure" reasoned that while this amount "may be to some extent unfair to plaintiffs, it avoids any possibility that the damages are fixed in an amount greater than could have been obtained by the defendants through recapture." (A. 59).

After the district court's decision and judgment, all petitioners retained new counsel, and petitioner Currier, for the

first time, retained counsel separate from the others.[7] Petitioners' motions for a new trial were denied.

The Opinion For Which Review Is Sought

On appeal, in *Fogel II*, petitioners Chestnutt, *et al.*, raised for the first time the argument that the complaint should be dismissed because there was no private right of action under the ICA. Also challenged was the district court's modification of the magistrate's report as to damages. Petitioner Currier joined in these arguments, but also argued separately that the judgment as to him should be reversed because he was an "unaffiliated" director and because he had received ineffective legal counsel from his attorney, Clendon H. Lee, who had failed to present his "special case". In the alternative, Currier argued that his liability should have been subordinated and damages should have been apportioned so as to at least minimize his liability.

The court of appeals held that it need not reach the issue whether a private right of action existed under the ICA for several reasons. First, the question was not one of subject matter jurisdiction which could be raised at any time during the pendency of the action. Rather, it was a question whether the complaint stated a cause of action for which relief could be granted—a defense which could be waived. (A. 7-12). The court went on to find that petitioners had in fact waived this defense by failing to include it in the pre-trial order, or otherwise press for a determination of the issue, even though it was admitted that petitioners' counsel was aware of the defense. (A. 12-14).

Second, the court of appeals held that the doctrine of law of the case precluded reconsideration of its decision on liability unless subsequent Supreme Court cases had created " 'a clear conviction of error' with respect to a point of law on which its previous decision was predicated." (A. 15). The court reviewed this Court's recent cases involving implication of private rights

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7 Until this time, all petitioners, including Currier, had been represented by Clendon H. Lee, who had acted as "Special Counsel" to both the Fund and the Advisor since 1965. (A. 136).

of action and concluded that there was no "clear conviction of error" which compelled a departure from the law of the case. (A. 14-21).

Thus, as against petitioners Chestnutt, *et al.* (No. 81-2163), the district court's judgment was affirmed in all respects.[8]

As to petitioner Currier's arguments (No. 81-2154) that he was an "unaffiliated" director who should not have been lumped together with the others, the court of appeals, noting that it had earlier found Currier "in fact not disinterested" and therefore liable (A. 108), held that:

> [I]t would be a dangerous precedent to depart from the law of the case simply because new counsel have come up with arguments that could equally well have been presented when the case was first here. Currier does not fit the picture of the guileless innocent that counsel seek to draw.
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> * * *
>
> Our opinion in *Fogel I,* knowledge of which he does not deny, should have alerted him to the need of having his "special case" presented by petition for reconsideration or, failing that, by offering proof before the Magistrate. Instead he continued to allow himself to be represented by Lee, whom, as we learn from Currier's affidavit supporting his post-trial motion, was doing this without additional compensation.

(A. 34). Nevertheless, the court of appeals did order a subordination of liability such that Currier is not liable at all unless the full judgment cannot be recovered from the Advisor. Further, the court limited Currier's liability for such unrecovered damages to "the ratio of his stock ownership in the Adviser in any year to the total stock ownership of all the individual defendants." (A. 35-36).[9]

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8 The court of appeals also affirmed the district court's modification of the magistrate's report. No question is presented in the present petitions as to this aspect of the decision below.

9 During the period in question, Currier's stock ownership declined from 2% to 1.2%. (A. 31). His potential liability is highly speculative given

Epilogue

The practices which were so hotly debated fourteen years ago when this action was commenced—give-ups, reciprocal brokerage, recapture and fixed commission rates—are today little more than historical curiosities. Give-ups were abolished in December 1968. (A. 90). Reciprocal brokerage was abolished effective July 15, 1973. (A. 96). Institutional membership—which is the *sine qua non* of all recapture—was phased out beginning in 1975. (A. 96). Finally, fixed commission rates—"the root of the recapture problem" (A. 78)—were outlawed by the SEC, and later Congress, also in 1975. (A. 96-97). *See, Gordon v. New York Stock Exchange,* 422 U.S. 659, 675-683 (1975) (describing events leading up to the termination of fixed brokerage commissions).

Moreover, as part of the Securities Act Amendments of 1975, (which ended institutional membership and fixed commission rates) Congress amended § 28 of the Securities Exchange Act of 1934 to provide that it would not be a breach of fiduciary duty if an investment adviser did not obtain the lowest possible brokerage commission for its client, such as a mutual fund. Concern was expressed that this provision might lead to the revival of give-ups and reciprocal brokerage, but Congress quickly put such concern to rest:

> The conferees analyzed the possibility that the fiduciary provision would be asserted as a shield behind which the give-ups and reciprocal practices which were so notorious during the late 1960's could be reinstituted. The conferees believe the new language would not permit such a result.

H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 108, *reprinted in* [1975] U.S. Code Cong. & Ad. News 321, 339.

REASONS FOR DENYING THE WRITS

The decision below turned on procedural issues. No substantive questions are raised by this case, the resolution of which

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the fact that there is no reason to assume that the Advisor is unable to pay the full judgment. *See also,* respondents' agreement noted at A. 6n.3.

would have precedential effect on pending or future cases. Rather, the petitions for certiorari invite this Court to undertake an excursion into history. As noted above, recapture has been a dead issue since 1975. Of the fifty cases brought during the height of the recapture controversy, (A. 77-78n.1), this is the only one, to our knowledge, still pending.

Petitioners' argument that an implied private right of action did not exist when this case was brought fourteen years ago is also now academic. In 1970, Congress enacted § 36(b) of the ICA which grants mutual fund shareholders an express private right of action. As the table offered by petitioners demonstrates (*see* Chestnutt Pet. at n.22), the cases presently pending under the ICA rely on this express right. Thus, the issues raised in the present petitions can have no effect on the pendency of those actions.

Petitioners' claim (Chestnutt Pet. at 6) that a conflict exists among the circuits on the implied right question is wishful thinking.[10] More to the point, however, this Court's recent decision in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Curran*, __ U.S. __, 72 L.Ed.2d 182 (1982), confirms the holding of the court below that there is no reason to depart from its earlier decision that respondents have a right to recover damages, under the ICA, for the benefit of a registered investment company.

The petitions also invite this Court to: abolish the well-established doctrine of "law of the case"; disregard the consistently drawn distinction between jurisdiction and cause of action; and amend the Federal Rules of Civil Procedure to

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10 Petitioners cite *Brouk v. Managed Funds, Inc.*, 286 F.2d 901 (8th Cir. 1961) as evidence of a conflict which "still exists" and which "this Court should now resolve . . . ." (Chestnutt Pet. at 16-17). The judgment of the court of appeals in *Brouk*, however, was vacated by this Court upon a suggestion of mootness. 369 U.S. 424 (1962). Under such circumstances, the decision of this Court "vacating the judgment of the Court of Appeals deprives that court's opinion of precedential effect . . . ." *County of Los Angeles v. Davis*, 440 U.S. 625, 634 n.6 (1979); *O'Connor v. Donaldson*, 422 U.S. 563, 577 n.12 (1975).

In any event, the Eighth Circuit itself has since disavowed *Brouk*. *Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 793 (8th Cir. 1967). Thus, whatever conflict may once have existed dissolved years ago. *See also*, A. 18n.11.

provide that the defense of failure to state a claim cannot be waived or abandoned. These extraordinary measures are sought as an accomodation to petitioners who, by their own admission, failed for more than twelve years to present a defense they were aware of at the time the action was commenced.

The petition of Currier (No. 81-2154) presents no legal issue for this Court to consider. After the decision of the court of appeals, Currier's liability to plaintiffs was subordinated to that of the Advisor and further significantly limited. It is highly speculative that he will ever have to pay a penny. In any event, as the opinion below makes clear, Currier was found liable for factual reasons plainly supported by the record. It is with that *factual finding* that Currier takes issue.

A. PETITIONERS HAVE WAIVED THE DEFENSE THAT THE COMPLAINT FAILED TO STATE A CLAIM UPON WHICH RELIEF COULD BE GRANTED

Although petitioners concede that they "clearly raised the issue of whether respondents could pursue a private right of action under the ICA in their answer" filed in 1969 (Chestnutt Pet. at 18; A. 150), the record is plain that they never pursued this defense until after there had been a trial on liability, an appeal (*Fogel I*), two post-appeal motions, and a petition to this Court for a writ of certiorari. While petitioners contend that their inaction was excusable given the legal thinking of the time (Chestnutt Pet. at 18), the fact is that both § 36(b) of the ICA and this Court's seminal decision in *Cort v. Ash*, 422 U.S. 66 (1975)—which are still the heart of petitioners' argument—were available well before *Fogel I*. Under these circumstances, it was clearly not error for the court of appeals to hold that petitioners had abandoned the defense.

On September 4, 1973, in anticipation of the trial on liability, the district judge entered a pre-trial order pursuant to Fed.R.Civ.P. 16. Petitioners' counsel participated in the preparation of that order. It included, *inter alia*, seventeen separately numbered "Defendants' Contentions." (*See* A. 141-144). None

of these contentions, however, challenged the existence of an implied right of action under the ICA.[11]

Fed.R.Civ.P. 16 directs that a pre-trial order "controls the subsequent course of the action, unless modified at the trial to prevent manifest injustice." In *United States v. Hougham*, 364 U.S. 310, 315 (1960), this Court stated that the "pre-trial order, as authorized by Rule 16, conclusively established the issues of fact and *law* in the case . . . ." (emphasis added). The purpose of such an order is to simplify the issues for trial (Fed.R.Civ.P. 16(1)) in order to conserve the litigants' time and money, as well as scare judicial resources. *Smith v. Ford Motor Co.*, 626 F.2d 784, 795 (10th Cir. 1980), *cert. denied*, 450 U.S. 918 (1981). 3 *J. Moore's Federal Practice* (2d ed. 1982) ¶ 16.02 at 16-5 to 16-7. Obviously, these salutary purposes are not achieved if parties are free to omit threshold issues—*e.g.* failure to state a claim—which might obviate the need for any trial at all. *Cf., United States v. Joyce*, 511 F.2d 1127, 1130 n.1 (9th Cir. 1978).

The court below assumed it had the power (not specifically granted by Rule 16) to amend the pre-trial order to prevent "manifest injustice." It held, however, that the burden of demonstrating such injustice is increased where, as here, the adverse party has been subjected to the expense and trouble of a trial on liability, an appeal and a second trial on damages. The court then found that one of the principal grounds for petitioners' argument against an implied right of action was the enactment of § 36(b) of the ICA in 1970. Since that argument could equally well have have been made at the time of the pre-trial order, petitioners could "scarcely meet" the test of manifest injustice.[12] In addition to § 36(b) itself, the legisla-

11 Petitioners claim that "[t]his legal issue was understandably not listed in the 1973 pre-trial order as one to be tried to the finder of fact" (Chestnutt Pet. at 18). However, as the court of appeals found (A. 12), petitioners did raise numerous other legal issues in that same order. Nor did the pre-trial order ever purport to distinguish between legal and factual issues, particularly since it was in anticipation of a bench trial.

12 Petitioners still rely heavily upon the enactment of § 36(b) for evidence that no implied remedies could exist under the ICA. (Chestnutt Pet. at 14-15). Section 36(b) was enacted on December 14, 1970 and became effective June 14, 1972. Pub. L. No. 91-547, § 30(4), Stat. at 1436.

:ive history of the 1970 amendments—upon which petitioners also now rely (Chestnutt Pet. at 14-15n.20)—was likewise available prior to the pre-trial order.

Further, no motion to dismiss was made; nor was any such argument presented at the 1973 trial on liability—though lack of a private right of action surely would have been germane to the question of liability.[13]

Similarly, no mention of this defense was ever made in connection with the first appeal of this case (*Fogel I*). By that time, this Court's decision in *Cort v. Ash, supra,* was available and should have resolved any hesitation petitioners' counsel purports to have had about raising the issue. Nonetheless, neither *Cort,* nor any argument as to implied rights of action, appeared in petitioners' *Fogel I* brief.[14] At oral argument—held September 22, 1975, some three months after *Cort*—again petitioners were silent on the implied rights issue. On January 14, 1976—after the decision in *Fogel I* and seven months after *Cort*—petitioners moved in the court of appeals for rehearing and rehearing in banc. Once again petitioners failed to raise the implied rights issue. On May 4, 1976, petitioners moved in the court of appeals to recall the mandate and vacate the judgment. *Cort,* then almost a year old, was not mentioned. Finally, on May 17, 1976, petitioners filed in this Court for a writ of certiorari (No. 75-1665). While the petition mentioned *Cort* in a string citation with four other unrelated cases (*see* Pet. in No. 75-1665 at 30) and used the words "implied remedy," no argument based on *Cort* was attempted, and no reference to the subject of private rights of action appears in

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13 For this reason, petitioners are also precluded from asserting the defense of failure to state a claim by Fed.R.Civ.P. 12(h)(1), which provides that such defenses must be raised at or before trial. *Brule v. Southworth,* 611 F.2d 406 (1st Cir. 1979); *Black, Sivalls & Bryson, Inc. v. Shondell,* 174 F.2d 587, 590-91 (8th Cir. 1949).

14 In all fairness, we must point out that *Cort v. Ash* was handed down only five days before petitioners' brief was served. Nevertheless, no attempt was made to postpone the deadline for this brief so it could include consideration of *Cort,* nor was any supplemental brief offered. *Cf.* Fed.R.App.P. 28(j).

the "Questions Presented for Review." (Pet. in No. 75-1665 at 30, 2-3).[15]

The court of appeals decision below does not hold that mere omission of an issue from a pre-trial order will forever bind a litigant regardless of the circumstances. What it does hold is that, in the situation presented here, where petitioners had the means to make an argument that might have disposed of this litigation at an early stage, they will not be permitted to let that argument lie dormant until their adversaries have been put to the burden of a trial on liability, an appeal, and a second trial on damages.

B. WHETHER A PRIVATE RIGHT OF ACTION EXISTS UNDER AN ACT OF CONGRESS IS NOT A QUESTION OF SUBJECT MATTER JURISDICTION

In an effort to avoid their waiver of the defense that there was no private right of action under the ICA in 1968, petitioners argue that such questions go to the subject matter jurisdiction of the federal courts and thus, cannot be waived and may be raised at any time during the course of the litigation. (Chestnutt Pet. at 21-29). In the opinion below, Judge Friendly, relying on this Court's many cases on the subject, so forcefully rejected this argument that petitioners have now added a fall-back position—never briefed, argued or decided below—that such defenses are "sufficiently analogous" to questions of subject matter jurisdiction that they should be raisable at any time. This argument asks the Court to enact a rule of convenience in aid of parties who have slept on their rights, thus repealing Fed.R.Civ.P. 12(h)(2). The reasoning in support of this novel rule was flatly rejected in *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 199-200.

Petitioners' primary arguments invites this Court to depart from its consistently drawn distinction between the judicial power to decide a case (jurisdiction) and the ability to grant

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15 Petitioners' one cryptic reference to "implied remedy" was based on the enactment of § 36(b)—available years before—and centered on burden of proof and limitation of recovery, not the threshold question of whether a right of action existed. *See* Petition in No. 75-1665 at 30.

relief under the circumstances (whether the complaint states a claim upon which relief can be granted). Although, as the court below pointed out, there has been some casual use of the term "jurisdiction" (A. 8, 11), the fact remains that each time this Court has had occasion to analyze the issue it has reached the same conclusion. As Justice Holmes put it in *The Fair v. Kohler Die & Specialty Co.*, 228 U.S. 22, 25 (1913):

> [W]hen the plaintiff bases his cause of action upon an act of Congress, jurisdiction cannot be defeated by a plea denying the merits of this claim . . . . Jurisdiction is authority to decide the case either way. Unsuccessful as well as successful suits may be brought upon the act, and a decision that a patent is bad, whether on the facts or the law, is as binding as one that it is good. See Fauntleroy v. Lum, 210 U.S. 230 . . . . [I]f the plaintiff really makes a substantial claim under an act of Congress there is jurisdiction whether the claim ultimately be held good or bad.

In *Bell v. Hood*, 327 U.S. 678, 682-83 (1946), Justice Black reaffirmed this principle:

> [I]t is well settled that the failure to state a proper cause of action calls for a judgment on the merits and not for a dismissal for want of jurisdiction. Whether the complaint states a cause of action on which relief could be granted is a question of law and just as issues of fact it must be decided after and not before the court has assumed jurisdiction over the controversy. If the court does later exercise its jurisdiction to determine that the allegations in the complaint do not state a ground for relief, then dismissal of the case would be on the merits, not for want of jurisdiction.

Accord, Davis v. Passman, 442 U.S. 228, 239 n.18 (1979); *Duke Power Co. v. Carolina Environmental Study Group, Inc.*, 438 U.S. 59, 70-71 (1978) (Burger, C.J.); *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 249 (1951).

More importantly, this Court has applied that reasoning under the very statute in issue here. In *Burks v. Lasker*, 441

U.S. 471 (1979), the Court assumed (for the purposes of its decision on other issues) that an implied private right of action existed under the ICA. If the question was jurisdictional, as defendants contend, such an assumption would have been improper (regardless of the failure of the parties or the courts below to raise it; *cf.* Chestnutt Pet. at 25). This Court, however, explained its action: "The question whether a cause of action exists is not a question of jurisdiction and therefore may be assumed without being decided." 441 U.S. at 476 n.5, *citing, Mt. Healthy City Board of Education v. Doyle,* 429 U.S. 274, 279 (1977).

Congress' intention to vest the federal courts with jurisdiction, in the circumstances presented here, is clearly expressed in § 44 of the ICA:

> The district courts of the United States . . . shall have jurisdiction . . . of all suits in equity and actions at law brought to enforce any liability or duty created by . . . this title or the rules, regulations, or orders thereunder.

In *Touche Ross & Co. v. Redington,* 442 U.S. 560 (1979), this Court was confronted with an argument that similar jurisdictional language in § 27 of the Securities Exchange Act of 1934 ("1934 Act") authorized a private right of action. In rejecting that argument, this Court again distinguished between jurisdiction and cause of action: "Section 27 grants jurisdiction to the federal courts . . . . It creates no cause of action of its own force and effect . . . ." 442 U.S. at 577. *See also, Securities Investor Protection Corp. v. Barbour,* 421 U.S. 412, 424 (1975) (where this Court noted that § 27 of the 1934 Act specifically granted the district courts jurisdiction, but "[t]he more difficult question was whether private parties, *once in court,* could seek damages . . . ."; emphasis added).[16]

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16 Petitioners' argument (Chestnutt Pet. at 24-25), based on the habeas corpus statute, that Congress sometimes sets preconditions to federal jurisdiction has no application here. Whether such preconditions are in fact jurisdictional depends on the language of the statute's jurisdictional provision. *Zipes v. Trans World Airlines, Inc.,* __ U.S. __, 71 L.Ed.2d 234, 243-44 (1982). Section 44 of the ICA includes no preconditions.

In the cases relied upon by petitioners (Chestnutt Pet. at 21-25), this Court's use of the term "jurisdiction" has not been in a context in which it was *necessary* to distinguish between subject matter jurisdiction and failure to state a claim upon which relief can be granted. In those cases where this Court was compelled to draw such a distinction, the decisions are uniform. Petitioners' "considerable uncertainty" (*id.* at 25) and "confusion on this point" (*id.* at 29) are of their own making and have not infected this Court.

Petitioners implicitly concede that this Court's decisions are uniformly against them when they revert to the novel[17] argument that questions of implied private rights of action should be treated as the "procedural equivalent of" or "sufficiently analogous to" a jurisdictional issue. (Chestnutt Pet. at 25-29). According to petitioners, if the federal courts imply a cause of action in favor of one to whom Congress meant to deny such right, they are "usurping functions vested in Congress" in violation of the doctrine of "separation of powers." (Chestnutt Pet. at 26-28). This Court, however, has already flatly rejected that contention—"there is no merit to the argument . . . that the judicial recognition of an implied private remedy violates the separation of powers doctrine." *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 199.

Moreover, the effect of petitioners' proposed rule on federal practice would be disastrous. First, Congress has already determined when the defense of failure to state a claim shall be raised and when issues of subject matter jurisdiction may be raised. Fed.R.Civ.P. 12(h). That legislative decision should not be repealed by this Court. Second, petitioners' rule would necessarily encourage carelessness. Indeed, its only purpose is to aid those who have not preserved their rights. Finally, the proposed rule would invite creative counsel (or, as here, new counsel) to continually attempt to relitigate issues which otherwise would have been deemed concluded). Surely such a result will not serve the purpose (which petitioners purport to endorse, Chestnutt Pet. at 25) of dealing with the increased complexity and volume of federal litigation.

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17 "Novel" both in the sense that it was never argued below and in that there is no precedent to support it.

In short, the one argument in favor of petitioners' proposed rule—aid to the careless—is hardly compelling; the arguments against it—outlined above—are decisive.

C. THE COURT OF APPEALS PROPERLY RULED THAT RELITIGATION OF PETITIONERS' LIABILITY WAS PRECLUDED BY THE LAW OF THE CASE

The court below ruled that, aside from waiver, petitioners were also precluded from fully relitigating the question of their liability by the principle of "law of the case." Responding to petitioners' contention that decisions of this Court subsequent to *Fogel I* had worked a change in the law regarding private causes of action under the ICA, the court below acknowledged that such fact, if demonstrable, would require a departure from its earlier decision. (A. 14-15). The court held, however, that "mere doubt" was not enough; "[t]he law of the case will be disregarded only when the court has 'a clear conviction of error' with respect to a point of law on which its previous decision was predicated." (*Id.*).[18] After giving "serious consideration" to petitioners' contention, the court held that it had "no such clear conviction that a private action will not lie under the ICA . . . ." (*Id.* at 15). This ruling is buttressed by the fact that petitioners themselves "must concede that the Supreme Court has not yet passed on the question whether private causes of action for damages can be implied from the ICA." (*Id.*).[19]

Rather than argue here that the court below misapplied the law of the case principle, petitioners attempt what they call a "simpler" point (Chestnutt Pet. at 19)—that the court of appeals had no authority to apply that principle at all. For support, petitioners invoke the general proposition that federal courts must apply the law as it exists at the time of decision. In short, petitioners invite the Court to abolish its long-standing

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18 In this respect, the court below agreed with the First Circuit's decision in *White v. Higgins*, 116 F.2d 312, 317 (1st Cir. 1940).

19 Indeed, this Court expressly declined to decide that very issue in *Burks v. Lasker, supra*, 441 U.S. at 476 n.5.

principle of law of the case[20] in favor of a purely mechanical rule requiring, without exception, application of current law. This Court has already expressly declined to do just that. *See Bradley v. Richmond School Board*, 416 U.S. 696, 715 (1974) (where the Court stated: "[N]either our decision in [*Thorpe v. Housing Authority of Durham*, 393 U.S. 268, 282 (1969)] nor our decision today purports to hold that courts *must always* apply new laws to pending cases . . . .") (emphasis added.)[21]

The problem with petitioners' argument is that they would not qualify under the rule they seek to make mandatory. That rule, as stated by petitioners themselves (Chestnutt Pet. at 19), is that "if subsequent to the judgment and before the decision of the appellate court, a law intervenes and *positively changes the rule which governs*, the law must be obeyed, or its obligation denied." *United States v. Schooner Peggy*, 5 U.S. (1 Cranch) 103, 110 (1801) (emphasis added). If petitioners were capable of demonstrating some decision of this Court which "positively changed" the rule holding them liable below, then they could equally well have satisfied the "clear conviction of error" standard applied by Judge Friendly.

The reason that the two legal principles—"law of the case" and "application of current law"—have managed to co-exist peacefully for more than a century is that the two are in basic harmony—they are two sides of the same coin. When a current law intervenes which "positively changes" prior law, then the law of case will yield under its "clear conviction of error" exception. If, as here, there is no "positive change," then the law of the case must hold firm to prevent wasteful reconsideration based on "mere doubt." (A. 15).

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20 The principle of law of the case has been recognized and employed by this Court for more than a century. *Insurance Group Committee v. Denver & Rio Grande Western R. Co.*, 329 U.S. 607, 612 (1947); *King v. West Virginia*, 216 U.S. 92, 100-101 (1910) (Holmes, J.); *Great Western Telegraph Co. v. Burnham*, 162 U.S. 339, 343-44 (1896); *Washington Bridge Co. v. Stewart*, 44 U.S. (3 How.) 413, 425 (1845).

21 In addition, as the Court observed in *Thorpe v. Housing Authority of Durham*, 393 U.S. 268, 282 (1969), exceptions "have been made to prevent manifest injustice . . . ." *Accord, Bradley, supra*, 416 U.S. at 716-17.

Thus, there is no need to accept petitioners' invitation to abolish the law of the case doctrine at this late date. Their real complaint is that they were unable to demonstrate (A. 14) that this Court has "positively changed" the law under the ICA. As shown in the following section, they have failed to do so here also.

D. RESPONDENTS HAVE A PRIVATE CAUSE OF ACTION FOR DAMAGES UNDER THE INVESTMENT COMPANY ACT OF 1940

Although the court below stopped just short of formally deciding whether respondents have a cause of action under the ICA, it did give "serious consideration" to the point, it reviewed this Court's authority on the subject, and it concluded that there was no "clear conviction" that its earlier decision holding petitioners liable under the ICA was erroneous under present law. (A. 14, 15-21). This Court's recent decision (rendered after *Fogel II*) in *Merrill Lynch v. Curran, supra,*—affirming a finding by Judge Friendly of an implied private right of action under the Commodities Exchange Act[22]—confirms the correctness of Judge Friendly's holding here.

1. The Federal Courts' Historical Recognition of A Private Right of Action Under the ICA Is Widespread And Uniform

In *Cannon v. University of Chicago,* 441 U.S. 677, 706 n.40 (1979), it was observed that:

> This Court has frequently accepted a history of federal-court recognition of a cause of action as indicative of the propriety of its implication.

This principle was reaffirmed this term in *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 201-203. Thus, for example, this

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22 *See Leist v. Simplot,* 638 F.2d 283 (2d Cir. 1980), *aff'd, sub nom. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Curran,* ___ U.S. ___, 72 L.Ed.2d 182 (1982).

Court has "explicitly acquiesced in the 25-year-old acceptance by the lower federal courts of a Rule 10b-5 cause of action." *Cannon v. University of Chicago, supra,* 441 U.S. at 690 n.13; *accord, Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 201-202]; *Touche Ross v. Redington, supra,* 442 U.S. at 577 n.19. Similarly, the Court relied upon such lower court recognition in upholding private rights under the Commodities Exchange Act in *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 202 and under Title IX of the Education Amendments Act of 1972 in *Cannon v. University of Chicago, supra,* 441 U.S. at 706 n.40.

The private right of action for breach of fiduciary duty under the ICA enjoys a similar tradition of uniform judicial acceptance reaching back more than twenty-five years. *Tannenbaum v. Zeller,* 552 F.2d 402, 417 (2d Cir.), *cert. denied,* 434 U.S. 934 (1977); *Fogel v. Chestnutt,* 533 F.2d 731 (2d Cir. 1975), *cert. denied,* 429 U.S. 824 (1976); *Rosenfeld v. Black,* 445 F.2d 1337 (2d Cir. 1971), *appeal dismissed,* 409 U.S. 802 (1972); *Moses v. Burgin,* 445 F.2d 369 (1st Cir.), *cert. denied,* 404 U.S. 994 (1971); *Herpich v. Wallace,* 430 F.2d 792, 815 (5th Cir. 1970) (*dicta; but see,* opinion below at A. 18 n.10); *Esplin v. Hirschi,* 402 F.2d 94, 103 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969); *Greater Iowa Corp. v. McLendon,* 378 F.2d 783, 793 (8th Cir. 1967); *Levitt v. Johnson,* 334 F.2d 815 (1st Cir. 1964), *cert. denied,* 379 U.S. 961 (1965); *Chabot v. Empire Trust Co.,* 301 F.2d 458 (2d Cir. 1962); *Cambridge Fund, Inc. v. Abella,* 501 F. Supp. 598 (S.D.N.Y. 1980); *Tanzer v. Huffines,* 314 F. Supp. 189, 195 (D. Del. 1970); *SEC v. Quing N. Wong,* 42 F.R.D. 599, 601 (D.P.R. 1967); *Entel v. Allen,* 270 F. Supp. 60, 65-66 (S.D.N.Y. 1967); *Brown v. Bullock,* 194 F. Supp. 207, 220 (S.D.N.Y.), *aff'd,* 294 F.2d 415 (2d Cir. 1961); *Taussig v. Wellington Fund, Inc.,* 187 F. Supp. 179, 216, 218 (D. Del. 1960), *aff'd,* 313 F.2d 472, 476 (3d Cir.), *cert. denied,* 374 U.S. 806 (1963); *Cogan v. Johnston,* 162 F. Supp. 907, 909 (S.D.N.Y. 1958); *Schwartz v. Bowman,* 156 F. Supp. 361 (S.D.N.Y. 1957), *appeal dismissed, but holding on this point aff'd sub nom. Schwartz v. Eaton,* 264 F.2d 195, 198 n.5 (2d Cir. 1959); *Breswick & Co. v. United States,* 134 F. Supp. 132,

138 (S.D.N.Y. 1955), *rev'd on other grounds*, 353 U.S. 151 (1957).[23]

While defendants complain that this "nose count" is not as overwhelming as that with respect to Rule 10b-5, as the court below held, "it is impressive enough." (A. 18).[24] In fact, Judge Friendly went further and declared that "the case for an implied cause of action under the ICA is stronger than [that] . . . as regards Rule 10b-5" since the Securities Exchange Act "had not been the subject of extensive overhaul" when the Rule 10b-5 remedy was endorsed,[25] while the ICA had been "significantly amended . . . long after the implied cause of action under it had been recognized." (A. 19). It is to this point—which anticipated this Court's holding in *Merrill Lynch v. Curran, supra*—that we now turn.

2. Congress Has Expressly Approved of And Relied Upon the Existence of An Implied Right of Action Under the ICA for Breach of Fiduciary Duty

In 1970, Congress made "comprehensive amendments to the Investment Company Act of 1940 . . . for the first time in three decades."[26] In the course of this overhaul, Congress received considerable testimony regarding judicial implication of private rights of action under the ICA. Thus, the entire case of *Brown v. Bullock*, 294 F.2d 415 (2d Cir. 1961)—one of the first to imply a private cause of action—was printed verbatim

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23 The lone dissenter from this impressive array was *Brouk v. Managed Funds, supra*, n.10, which, for the reasons given above, is no longer viable precedent.

24 It is certainly far more "impressive" than judicial recognition of implied rights under either the Commodities Exchange Act or Title IX of the Education Amendments Act.

25 *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

26 H.R. Rep. No. 91-1382, 91st Cong., 2d Sess. 1 (1970) ("1970 House Report").

Sections 2, 3, 8-13, 15, 17-19, 22, 24-28, 31, 33, 36 and 42-44 of the ICA were all amended in one fashion or another.

in the Senate record,[27] and the author of that opinion, Judge Friendly, testified concerning it before the House Committee.[28] Philip Loomis, General Counsel of the SEC, also testified with respect to shareholder suits under the ICA.[29]

While, as petitioners point out (Chestnutt Pet. at 14-15n.20), there was some testimony in 1967 regarding *Brouk v. Managed Funds, supra,* n.10, by 1970 (after the Eighth Circuit itself had expressly disavowed *Brouk*) the House Report stated unequivocally that:

> Under *existing provisions* of the act, a fund shareholder can challenge the investment advisory fee by a suit under section 36 of the Act alleging gross abuse of trust on the part of the fund directors in agreeing to the management fee.[30]

Thus, Congress was plainly aware that private rights of action had been implied under the ICA.[31]

Petitioners urge that by enacting § 36(b)—an express remedy designed to overcome obstacles created by the courts in one specific area of litigation (*see* A. 19-20)—Congress must have intended to eliminate all other implied remedies. (Chestnutt Pet. at 14-15). Nothing in the legislative history of the 1970 amendments even hints at such a result and each court to

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27 Hearings on S.1659 Before the Senate Committee on Banking and Currency, 90th Cong., 1st Sess. 68 (1967) ("1967" Senate Hearings").

28 Hearings on H.R. 9510, H.R. 9511 Before the House Committee on Interstate and Foreign Commerce, 90th Cong., 1st Sess. 610 (1967) ("1967 House Hearings"). Judge Friendly's testimony was also reprinted in the Senate record. 1967 Senate Hearings at 1014.

29 Hearings H.R. 11995, S.2224, H.R. 13754, H.R. 14737 Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 91st Cong., 1st Sess. 183-84 (1969).

30 1970 House Report at 7 (emphasis added).

31 If there is room for doubt on this point, it must be resolved in favor of congressional awareness of implied remedies for ' "[it] is always appropriate to assume that our elected representatives, like other citizens, know the law.' " *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 201, *quoting, Cannon v. University of Chicago, supra,* 441 U.S. at 696-97.

confront the issue (and some members of this Court) have decided that Congress meant to preserve implied remedies. *Fogel II*, A. 17-18; 19-21; *Tannenbaum v. Zeller, supra*, 552 F.2d at 417; *Cambridge Fund, Inc. v. Abella, supra*, 501 F. Supp. at 622-23; *see also Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis*, 444 U.S. 11, 33 n.9 (1979) (Opinion of White, J., with whom Justices Brennan, Marshall and Stevens joined dissenting).[32] Congress itself confirmed this point in 1975.

In that year, Congress again amended the ICA,[33] this time in response to *Rosenfeld v. Black, supra*, which had held an investment advisor liable under the ICA for breach of fiduciary duty in selling, for profit, its office as advisor to the fund.

Congress was evidently dissatisfied with the result reached in *Rosenfeld*. Rather than simply eliminating the implied private cause of action which had led to the *Rosenfeld* decision, however, Congress amended the ICA to permit advisors to sell their office, but subject to certain conditions. Only if these conditions were met did the advisor enjoy "insulation from liability."[34] Indeed, Congress went even further. The mutual fund industry had proposed legislation which would have made the 1975 amendment operate retroactively. *Newman v. Stein*, 464 F.2d 689, 695-96 (2d Cir.), *cert. denied*, 409 U.S. 1039 (1972). Congress, however, rejected this proposal—thus ensuring that pending cases based on implied rights of action would be unaffected. *See* § 15(f) of the ICA.

In *Merrill Lynch v. Curran, supra*, 72 L.Ed.2d at 204, 206, this Court was confronted with a similar situation under the

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32 "[T]he committee reports accompanying the 1970 amendments clearly indicated that the provision of express rights of action was not intended to affect the availability of implied rights of action elsewhere.

The majority in *Transamerica* expressed no opinion on this issue.

33 Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975).

34 S. Rep. No. 94-75, 94th Cong., 1st Sess. 140, *reprinted in* [1975] U.S. Code Cong. & Ad. News 317.

Commodities Exchange Act. There, suits against exchanges based on implied causes of action had caused the exchanges to cut back on their rule-making—a problem Congress sought to remedy. As this Court noted: "Congress could have removed this impediment to exchange rule making by eliminating the implied private remedy, but it did not follow that course." *Id.* at 204. Instead, as it did under the ICA in 1975, Congress amended the Commodities Exchange Act to preserve the implied cause of action, yet eliminate a particular problem such action had caused in one specific area.

This amendment was cited in *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 206-207, as evidence of Congressional intent to preserve the judicially implied remedies under the Commodities Exchange Act. The same holds true under the ICA.[35]

In 1980, Congress again amended the ICA.[36] In so doing, Congress took the opportunity to make explicit that it was aware of, approved of, and most importantly, that it was relying upon the continued implication of a private cause of action under the ICA for breach of fiduciary duty. As the Senate Report put it:

> [P]rivate lawsuits serve as an added deterrent to conduct made unlawful by Congress without the necessity of governmental involvement. The Committee wishes to make clear that private rights of action under this bill should be implied . . . *to the same extent that such causes of action are implied under the Investment Company Act.*[37]

The House Report is even more to the point:

> The Committee wishes to make plain that it expects the courts to imply private rights of action under this legisla-

35 Petitioners' contention that no private action ever lay under the ICA would mean that Congress regulated what did not exist, and would reduce the 1975 amendment to an absurdity.

36 Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275 (1980).

37 S. Rep. No. 96-958, 96th Cong., 2d Sess. 14 (1980). (Emphasis added).

> tion, where the plaintiff falls within the class of persons protected by the statutory provision in question. Such a right would be consistent with and further Congress' intent in enacting that provision . . . . In appropriate instances, for example, *breaches of fiduciary duty* involving personal misconduct should be remedied under Section 36(a) of the Investment Company Act. With respect to business development companies, *the Committee contemplates suits by shareholders as well as by the Commission, since these are the persons the provision is designed to protect, and such private rights of action will assist in carrying out the remedial purposes of Section 36.*[38]

As an example of the implied cause of action Congress contemplated, the House Report expressly refers to *Fogel I. Id.* at 26.

Thus, Congress has expressly approved of an relied upon the very implied cause of action, *indeed the very case,* petitioners ask this Court to overturn. In similar circumstances this Court has declined to tamper with judicial interpretations upon which Congress has relied. Thus, in *Edmonds v. Compagnie Generale Transatlantique,* 443 U.S. 256, 273 (1979), the Court held:

> Once Congress has relied upon conditions that the courts have created, we are not as free as we would otherwise be to change them. A change in the conditions would effectively alter the statute by causing it to reach different results than Congress envisioned.[39]

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38 H.R. Rep. No. 96-1341, 96th Cong., 2d Sess. 29 (1980). (Emphasis added).

39 *Edmonds* involved the apportionment of liability among an injured longshoreman, his employer, and the vessel. Under traditional maritime law, the longshoreman could recover of the vessel the entire extent of his injuries (except that portion caused by his own negligence) even if his employer was also at fault. One question before the Court was whether this judge-made doctrine of no apportionment between the vessel and the employer should be changed. 443 U.S. at 271. The Court held that since Congress relied upon the existence of this judicial interpretation when it enacted the 1972 amendments to the Longshoremen's and Harbor Worker's Compensation Act, reversal by the Court of that doctrine which Congress "did not itself wish to modify. . . might knock out of kilter [the] delicate balance" achieved by those amend-

Accord, Illinois Brick Co. v. Illinois, 431 U.S. 720, 736-37 (1977).

To hold now that no implied cause of action exists under the ICA for breach of fiduciary duty would stultify the investor protections Congress thought it had created in 1940 and preserved in the 1970, 1975 and 1980 amendments. Obviously, such a holding would "effectively alter the statute by causing it to reach different results than Congress envisioned." *Edmonds, supra.* Any such radical surgery should come from Congress, not the courts.[40]

3. Petitioners' Reliance on *Transamerica* is Misplaced

Petitioners place near total reliance on this Court's decision, in *Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis, supra*, 444 U.S. 11 (1979), that no implied cause of action exists under the Investment Advisers Act of 1940 ("Advisers Act") for breach of fiduciary duty. Noting that the Adviser's Act and the ICA were "enacted simultaneously," petitioners reason that it is "impossible to conclude that Congress had two different legislative intentions . . ." as to the two statutes. (Chestnutt Pet. at 14). If one looks to the language of the statutes, however, rather than their dates of enactment, it is "impossible to conclude" otherwise.

As the original legislative history of the ICA makes clear, the statute was enacted "to protect small investors from breaches of trust upon the part of unscrupulous managements. . . ."[41] Such protection was necessary because, as this Court has observed, the "relationship between investment advisers and

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ments. Accordingly, the Court left the judicial doctrine intact. 443 U.S. at 273. These same considerations apply with equal force to the case at hand.

40 Moreover, the argument in favor of implied rights here is even stronger than that in *Merrill Lynch v. Curran, supra*, 72 L.Ed.2d at 203, where the Court *inferred* that Congress intended to preserve remedies. Here, Congress has *expressly* declared its intention to do so and has cited this very case as an example of what it wants. *See* pp. 21-26, *supra*.

41 H.R. Rep. No. 2639, 76th Cong., 3d Sess. 10 (1940). *Accord*, S. Rep. No. 1775, 76th Cong., 3d Sess. 12 (1940).

mutual funds is fraught with potential conflicts of interest." *Burks v. Lasker, supra,* 441 U.S. at 481.

In § 1 of the ICA, Congress specifically listed such conflicts of interest among the abuses at which the Act was directed:

> (b) . . . it is hereby declared that the national public interest and the interest of investors are adversely affected—
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> * * *
>
> (2) when investment companies are organized, operated, managed, . . . in the interest of directors, officers, investment advisers, . . . rather than in the interest of all classes of such companies' security holders.

Not content to merely expose such abuses, Congress also issued a "directive to the courts" (A. 17n.9) that those abuses be eliminated, or at least mitigated:

> It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title *shall* be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors. (Emphasis added).

Section 1(b) of the ICA.[42] The Advisers Act, at issue in *Transamerica,* contains no such list of specific abuses and no such directive to the courts to eliminate those abuses.

Similarly, the jurisdictional provision of the ICA, § 44 (*see* p. 15, *supra*), contains the very language—"actions at law" and "liability"—the omission of which from the Advisers Act this Court found so telling in *Transamerica, supra,* 444 U.S. at 21-22. As the court noted in *Brown* v. *Bullock, supra,* 194 F. Supp. at 246, § 44 of the ICA clearly contemplates private actions:

> Since the Commission can bring only equity suits and only in the federal courts [sections 35(d), 36 and 42(e)],

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42 In addition to the decision below (A. 16-17), courts have traditionally construed § 1 as confirming a fiduciary duty. *Rosenfeld v. Black, supra,* 445 F.2d at 1344-45; *Moses v. Burgin, supra,* 445 F.2d at 384; *Aldred Inv. Trust v. SEC,* 151 F.2d 254, 260 (1st Cir. 1945), *cert. denied,* 326 U.S. 795 (1946).

> the other elements in section 44 [i.e. "actions at law" and concurrent jurisdiction] must refer to appropriate private actions and suits, in the proper federal or state court to enforce any liability created by the Act.[43]

Petitioners insist that the court below erred because it did not single out a "specific provision" of the ICA as the source of petitioners' liability (although the court did cite § 1) and that failure to do so was tantamount to the creation of "federal common law." (Chestnutt Pet. at 8-15).[44] Such precision, however, is not necessary (nor to be expected) in statutes enacted over thirty years before this Court, in 1975, modified its approach regarding implied remedies. Indeed, to discriminately apply the recently adopted strict standard to pre-existing remedial statutes is more likely to frustrate, than implement, the intent of a Congress operating under the former regime.[45] Thus, this Court, sensitive to the "legal context in which Congress acted," has held that such precision is not an absolute requirement. *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 198, 201, 206-207; *Cannon v. University of Chicago, supra,* 441 U.S. at 717. Moreover, to rely on the statute as a whole is not, as petitioners suggest, the creation of "federal common law." It is merely another method of gleaning congressional intent—a method specifically endorsed in petitioners' primary authority, *Transamerica, supra,* 444 U.S. at 18, where this Court held that "an intent [to make a private remedy available]

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43 The language of § 44 is obviously far too broad to accomodate only the action provided in § 30(f) to recover short-swing profits. For instance, a short-swing transaction cannot be enjoined, only the profits may be recouped.

44 Petitioners, as they did below, volunteer § 36 as the source of this liability and then attempt to shoot it down. (Chestnutt Pet. at 11-15). Contrary to petitioners' assertion (*Id.* at 8), the court, in *Fogel I,* never limited itself to § 36. In fact, it expressly disavowed reliance solely on § 36, and to drive the point home, cited two cases which did not rely on § 36. (A. 99).

45 As this Court noted in *Merrill Lynch v. Curran, supra,* 72 L.Ed.2d at 198-200, until 1975, denial of a remedy under a federal statute enacted for the benefit of a special class was "the exception rather than the rule." At the time the ICA was enacted, Congress had a duty to speak only if it *did not* intend a private remedy; silence presumptively authorized one. *Id.*

may appear *implicitly* in the language or structure of the statute, *or in the circumstances of its enactment.*" (Emphasis added).

Finally, petitioners' review of the 1940 legislative history does not advance their argument. David Schenker's observation (Chestnutt Pet. at 12) that § 36 creates and grants to the SEC the previously unknown remedy of enjoining officers and directors from holding office does not compel the conclusion that Congress meant to deny traditional remedies to small investors, the intended beneficiaries of the Act.[46] Similarly, the language quoted, *id.* at 9, applies, as clearly indicated, to §§ 38-46 and 49 of the Act, which "circumscribe" the *SEC's* authority.[47] It has nothing to do with private litigants.

For the reasons stated above, the Court below did not err in holding that petitioners had failed to demonstrate "a clear conviction of error" as to *Fogel I*, which held them liable under the ICA for breach of fiduciary duty.

E. THE COURT BELOW SUBORDINATED AND THEN FURTHER LIMITED CURRIER'S LIABILITY: IT DID NOT ERR BY REFUSING TO EXONERATE HIM ENTIRELY

As noted, *supra* at 7, petitioner Currier's request to the court below for subordination and further limitation of his liability was granted. The chances that he will ever have to pay a penny of the judgment are exceedingly remote. *See* n.9, *supra*.

Currier now asks this Court to remove even this last vestige of possible liability on factual grounds which could have been presented below, but were not because his former counsel repeatedly refused to argue his "special case." As the court of

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46 Congress' need to specifically delineate such novel remedies explains also § 30(f)—the one express private right of action in the ICA prior to 1970—which creates the remedy, unknown to the common law, of disgorgement of short-swing transactions. But expression of novel remedies is not inconsistent with acceptance of implied traditional remedies.

47 Thus, § 39 requires SEC compliance with the Federal Register Act; § 40(a) permits the issuance of SEC orders only after notice and opportunity for hearing; § 41 requires the SEC to keep records of its hearings; § 43 authorizes court review of SEC orders; and so on.

appeals noted in rejecting Currier's attempt to relitigate the issue there: "it would be a dangerous precedent to depart from the law of the case [holding Currier liable] simply because new counsel have come up with arguments that could equally well have been presented when the case was first here." (A. 34).[48] This holding is consistent with *Link v. Wabash R. Co.*, 370 U.S. 626, 633-34 (1962) where the Court held that a party who has voluntarily chosen his own attorney "cannot . . . avoid the consequences of the acts or omissions of his freely selected agent." In addition, as the court below noted, Currier *himself* was guilty of acquiescing in Mr. Lee's inaction long after he should have been alerted to the need of having his "special case" properly presented. (A. 34).

For these reasons, the court below did not err in refusing to reconsider Currier's liability or to exonerate him entirely.

CONCLUSION

For the reasons set forth above and in the decision below, the petitions for certiorari should be denied.

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Respectfully submitted

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48 Currier's present argument based on *Moses v. Burgin, supra*, (Currier Pet. at 5-6) obviously qualifies as such an argument, since *Moses* predated *Fogel I* by several years.